

**MUSICK, PEELER & GARRETT LLP**

ATTORNEYS AT LAW  
One Wilshire Boulevard, Suite 2000  
Los Angeles, California 90017-3383  
TELEPHONE 213-629-7612  
FACSIMILE (213) 624-1376

Susan J. Field (State Bar No. 086200)  
s.field@mpglaw.com  
Richard S. Conn (State Bar No. 065513)  
r.conn@mpglaw.com  
Barbora Pulmanova (State Bar No. 234028)  
b.pulmanova@mpglaw.com

Attorneys for NATIONAL INDEMNITY COMPANY

**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA**

STEVE POIZNER, INSURANCE  
COMMISSIONER OF THE STATE  
OF CALIFORNIA, in his capacity as  
Liquidator of Frontier Pacific Insurance  
Company,

Plaintiff,

vs.

NATIONAL INDEMNITY  
COMPANY, a Nebraska corporation;  
and DOES 1 through 10,

Defendant.

Case No. 08 CV 772 L (POR)

Assigned to the Hon. M. James Lorenz  
Courtroom 14

Complaint Filed: March 17, 2008

**MEMORANDUM OF DEFENDANT  
NATIONAL INDEMNITY CO. IN  
AID OF EARLY NEUTRAL  
EVALUATION CONFERENCE**

**DATE:** June 30, 2008  
**TIME:** 10:30 a.m.  
**COURTROOM:** H  
Chambers of the  
Honorable Louisa  
S. Porter

Defendant National Indemnity Company ("NICO") submits the  
following Memorandum in Aid of Early Neutral Evaluation Conference:

**I. STATEMENT OF MATTERS IN CONTROVERSY**

This action has been brought by Steve Poizner, Insurance  
Commissioner of the State of California ("Plaintiff" or "Commissioner"), in his  
capacity as Liquidator of Frontier Pacific Insurance Company ("FPIC").

1 (Complaint, p. 1) Plaintiff seeks “a determination that [FPIC’s] right to recover  
 2 monies owed by National Indemnity Company (“NICO”) pursuant to an indemnity  
 3 contract is not subject to any claim of offset for monies that were presently owed to  
 4 NICO from Frontier Insurance Company (“Frontier”), FPIC’s parent company.”  
 5 (Complaint, p. 2, ¶ 1) Frontier and FPIC are subject to state court supervised  
 6 insolvency proceedings in New York and California, respectively. (Complaint, p. 2,  
 7 ¶¶ 4-5)

8 Plaintiff initially sued NICO in San Diego Superior Court. NICO  
 9 caused the superior court action to be removed to this court on grounds of diversity  
 10 - - Plaintiff being a citizen of California and NICO having its principal place of  
 11 business and state of incorporation in Nebraska. (Complaint, pp. 2-3, ¶ 6)

12 The indebtedness of Frontier which NICO allegedly seeks to offset  
 13 arose under a reinsurance agreement effective January 1, 1995, which is attached to  
 14 the Complaint as Exhibit “A”. (Complaint, p. 3, ¶ 9) The Complaint refers to this  
 15 agreement as the Center Re Agreement, because Center Reinsurance Company of  
 16 New York (“Center Re”) was initially obligated as reinsurer thereunder. NICO  
 17 became the ultimate Reinsurer under the Center Re Agreement by virtue of a  
 18 Novation Agreement (Complaint, Ex. C) effective July 1, 2000. Both Frontier and  
 19 FPIC were parties to the Novation Agreement. (Complaint, p. 4, ¶ 14) Under the  
 20 Center Re Agreement, the Reinsured party was entitled to retain 92% of collected  
 21 premium in order to defray losses (the “Center Re Funds Held”). Unexpended  
 22 premium (the “Funds Withheld”) was ultimately required to be remitted to the  
 23 Reinsurer.

24 Plaintiff alleges that as of October 15, 2001, when the Supreme Court  
 25 of the State of New York issued an Order of Rehabilitation respecting Frontier,  
 26 “Frontier owed approximately \$40 million in premiums to NICO under the  
 27 Novation Agreement to fund the Center Re Funds Held deficiency due at December  
 28 31, 2003.” Review of the Center Re Agreement, Exhibit A, discloses that FPIC was

1 jointly and severally liable for the same indebtedness: page one of Exhibit A  
 2 defines Frontier and FPIC collectively as “the Company” and, pursuant to Article  
 3 XIG, “[t]he Company promises to pay the Funds Withheld Balance” on the earlier  
 4 of various stated contingencies. (Complaint, Ex. A, p. 7)

5 Notably, the Center Re Agreement contains the following provision for  
 6 comprehensive, binding arbitration: “Any dispute arising out of the interpretation,  
 7 performance or breach of this Agreement ... shall be submitted for decision to a  
 8 panel of three arbitrators. \*\*\* The panel shall render its decision within sixty (60)  
 9 days following the termination of hearings, which decision shall be in writing,  
 10 stating the reasons thereof. Judgment upon the award may be entered in any court  
 11 having jurisdiction thereof.” (Complaint, Ex. A, pp. 17-18, Art. XXVII) The  
 12 Center Re Agreement likewise provides for the arbitration to proceed in New York  
 13 City, pursuant to the laws of the State of New York. (op. cit.)

14 NICO served as reinsurer for Frontier and FPIC under other agreements  
 15 as well. (Complaint, ¶¶ 17) Among these was an agreement with Frontier effective  
 16 July 1, 2000, (the “NICO Agreement”) to which FPIC was added as a reinsured  
 17 effective October 1, 2000. (Complaint, Exs. D and E)

18 Subsequent to initiation of Frontier’s insolvency proceedings, NICO  
 19 and Frontier entered into Endorsement No. 3 to the NICO Agreement. (FPIC was  
 20 not a party to Endorsement No. 3.) Under Endorsement No. 3, NICO forgave and  
 21 released Frontier of indebtedness in the amount of \$140,000,000. NICO agreed “not  
 22 to collect [the Center Re Funds Held balance at December 31, 2003] from Frontier  
 23 (emph. supp.) as part of the \$140,000,000 NICO balance forgiveness ...”  
 24 (Complaint, Ex. H, p. 3, ¶¶ 8-9) While, pursuant to Endorsement No. 3, NICO  
 25 clearly thus foregoes recourse against Frontier for recovery of the Center Re Funds  
 26 Held balance, Endorsement No. 3 makes equally clear that NICO is not releasing  
 27 other obligors - - such as FPIC: “The Reinsurer agrees that it may only collect the  
 28 remaining funds held balance from the other participants to the Center Re

1 Reinsurance Agreements and Novation,” subject to a veto right by Frontier.<sup>1</sup>  
 2 (Complaint, Ex. H, p. 3, ¶ 9)

3 The Complaint alleges that “Endorsement No. 3 has been fully  
 4 performed by NICO and Frontier and Frontier and FPIC’s obligations under the  
 5 Reinsurance Agreements for payment of premium has been fully discharged and  
 6 satisfied.” (Complaint, p. 8, ¶ 37) Based on this contention, FPIC alleges NICO  
 7 currently holds no setoff rights (e.g. that NICO is owed no Withheld Funds) and that  
 8 NICO owes FPIC \$4,883,090 under the NICO Agreement. (Complaint, p. 9, ¶ 42;  
 9 Ex. M)

10 Notably the NICO Agreement, to which FPIC is a party, contains the  
 11 following provision for binding arbitration: “All matters in difference between the  
 12 Reinsured and the Reinsurer ... in relation to this reinsurance, including its  
 13 formation and validity, and whether arising during or after the period of this  
 14 reinsurance, shall be referred to an Arbitration Tribunal ... \*\*\* The award of the  
 15 Arbitration Tribunal shall be in writing and binding on the parties who covenant to  
 16 carry out the same.” (Complaint, Ex. D, p. 9, Art. 18) As with the Center Re  
 17 Agreement, the NICO Agreement provides that the Arbitration will proceed in New  
 18 York City, in accordance with the laws of the State of New York.

19 The Complaint alleges a right to declaratory relief as to three issues:  
 20 that FPIC is not bound by Endorsement No. 3, as purportedly contended by NICO  
 21 (Complaint, First Cause of Action, pp. 9-10); that Endorsement No. 3 constituted an  
 22 accord and satisfaction as to the obligation of FPIC to pay the Center Re Funds Held  
 23 balance (Complaint, Second Cause of Action, p. 10); and for a determination that  
 24 NICO is barred by California Insurance Code section 1031 from setting off monies  
 25

26 <sup>1</sup> Frontier had an interest in whether the Center Re Funds Held balance was  
 27 collected from other participants. To the extent the Center Re Funds Held balance  
 28 was applied against claims of FPIC, this would preserve limits available to Frontier  
 under the NICO Agreement.

1 it owes FPIC against monies due NICO from Frontier and otherwise discharged by  
 2 Endorsement No. 3. (Complaint, Third Cause of Action, pp. 10-11) The Complaint  
 3 thus asks the Court to determine the legal effect of Endorsement No. 3 on the Center  
 4 Re Agreement, as well as the validity of an affirmative defense raised by FPIC to  
 5 claims of NICO under the Center Re Agreement: accord and satisfaction. *See Mass*  
 6 *v. Melymont*, 1 Misc. 3d 906A, 2003 WL 23138786 (N.Y. Dist. Ct. 2003) (“In the  
 7 case at bar, accord and satisfaction as an affirmative defense can be raised by  
 8 defendant and employed successfully to preclude recovery providing that it is  
 9 properly raised.”). The Complaint in turn asks the Court to rule on an affirmative  
 10 defense asserted by NICO to claims of FPIC under the NICO Agreement - - the  
 11 affirmative defense of set off. *See Kivort Steel Inc. v. Liberty Leather Corp.*, 110  
 12 A.D.2d 950, 952, 487 N.Y.S.2d 877 (1985).

13 The Complaint further implicitly asks the Court to indulge the  
 14 assumption that FPIC is not now and never has been liable as a joint obligor with  
 15 Frontier for payment of the Center Re Funds Held balance – a proposition belied by  
 16 the very face of the Center Re Agreement.

17 NICO ’s Answer to Complaint discloses differences both over the  
 18 nature of matters in controversy and the substantive rights of the parties. For  
 19 example, NICO denies that Frontier has fully satisfied the Center Re Funds Held  
 20 obligation by virtue of Endorsement No. 3. (Answer to Complaint, ¶ 37) NICO  
 21 denies that its claim of set off arises under Endorsement No. 3 (Answer, p. 10, ¶ 46),  
 22 or by virtue of the indebtedness of Frontier, maintaining that it is entitled to assert  
 23 setoff by virtue of the joint and several liability of FPIC as part of the collective  
 24 “Company” under the Center Re Agreement. Similarly, NICO denies that  
 25 Endorsement No. 3 has the legal effect of an accord and satisfaction as to FPIC.  
 26 (Answer to Complaint p. 11, ¶ 50) To the extent that Endorsement No. 3 is  
 27 susceptible to such a construction, NICO maintains that it is subject to reformation.  
 28 (Answer to Complaint p. 12, ¶ 56) NICO further maintains that Frontier is an



1 indispensable party to any dispute resolution process addressing rights under the  
2 Center Re Agreement and NICO Agreement. (Answer to Complaint p. 12, ¶ 55)

3 Remarkably, although both of the agreements which give rise to the  
4 current controversy provide for binding arbitration, the Plaintiff has refused NICO's  
5 demand to submit the instant controversy to binding arbitration. This has  
6 necessitated NICO's filing of a motion to stay this litigation pending arbitration  
7 proceedings mandated by the Federal Arbitration Act. A copy of this motion,  
8 without exhibits, is attached as Exhibit "A".

## 9 **II. POSITION OF NICO RE DISCOVERY**

10 NICO submits that, in light of the mandatory arbitration provisions in  
11 each reinsurance contract and the strong presumption in favor of arbitration under  
12 the Federal Arbitration Act, there is a high probability that this action will be stayed  
13 pending conduct of an arbitration in New York City, New York. Accordingly,  
14 decisions concerning the scheduling of discovery should be deferred pending the  
15 Court's ruling on the Motion To Stay Prosecution of Action Pending Arbitration of  
16 Claims, to be set for hearing on August 18, 2008.

## 17 **III. POSITION OF NICO REGARDING MERITS OF UNDERLYING** 18 **CONTROVERSY**

19 NICO believes that the Complaint is predicated on certain fundamental  
20 misunderstandings concerning its legal contentions, applicable law, and undisputed  
21 facts. For example, the Commissioner maintains by way of the Complaint that  
22 NICO seeks to hold FPIC liable for the Funds Held Balance based on Endorsement  
23 No. 3 to the NICO Agreement. Nothing could be further from the truth. The  
24 liability of FPIC for the Funds Held Balance is evident on the face of the Center Re  
25 Agreement, in which both Frontier and FPIC are collectively, referred to as "the  
26 Company". As remarked in Williston On Contracts (4<sup>th</sup> Ed.) §36:1 at p.610,  
27 "Copromissors are liable 'jointly' if all of them have promised the entire  
28 performance which is the subject of the Contract." In that the Center Re Agreement

1 does not purport to create separate and distinct obligations for Frontier and FPIC  
2 with respect to the Funds Held Balance, FPIC is jointly liable for the whole amount.

3 NICO thus need not refer to, or rely on, Endorsement No. 3 to the  
4 NICO Agreement in order to establish prima facie liability on the part of FPIC.

5 The second legally untenable position asserted in the Complaint is that  
6 the settlement between Frontier and NICO, as reflected in Endorsement No. 3, has  
7 the effect of an accord and satisfaction vis a vis FPIC. Thus, FPIC implicitly asserts  
8 that it was the intention of Frontier and NICO in entering into Endorsement No. 3  
9 fully to satisfy the joint liability of FPIC for the Funds Held Balance. This  
10 contention is patently at odds with the provision of Endorsement No. 3 allowing  
11 NICO to collect "the remaining funds held balance from the other participants to the  
12 Center Re Reinsurance Agreements and Novation," subject to the concurrence of  
13 Frontier. Such language is an express reservation of rights against a third party,  
14 nullifying any benefit which otherwise might be claimed by FPIC by virtue of the  
15 release language of Endorsement No. 3. See N.Y. General Obligation Law §15-104  
16 "...the obligee's release or discharge of one or more of... joint, or of joint and  
17 several obligors shall not discharge co-obligors against whom the obligee in writing  
18 and as part of the same transaction as the release or discharge, expressly reserves his  
19 rights..."

20 Plaintiff may argue that continuing liability on the part of FPIC is  
21 inconsistent with language of Endorsement No. 3 referring to "forgiveness" of the  
22 Funds Held Balance. However, representatives of both Frontier and NICO will  
23 testify that the reference to "forgiveness" of the Funds Held Balance was intended  
24 solely as confirmation of a covenant not to enforce the debt as to Frontier. Both  
25 Frontier and NICO recognized that, even after the "forgiveness", the entire balance  
26  
27  
28

1 remained owing by the other co-obligors.<sup>2</sup> It is this intention, rather than any  
 2 technical construction of Endorsement No. 3, which must control interpretation of  
 3 the Endorsement. See *NAB Construction Corp. v. City of New York*, 276 A.D. 2d  
 4 388, 389, 390, 714 N.Y.S. 2d 279 (2000) (scope of release, absolute on its face,  
 5 must be determined in the context of the wider dealings of the parties and the  
 6 intentions thereby revealed); *Plath v. Justus*, 28 N.Y. 2d 16 (1971) (release of auto  
 7 driver liable for wrongful death deemed covenant not to sue, where right to proceed  
 8 against others reserved; action against owner of vehicle not barred).

9 Even if an arbitrator were in doubt concerning the construction of  
 10 Endorsement No. 3, given the agreement of both parties to the endorsement that a  
 11 substantial Funds Held Balance remained owing and that this amount was  
 12 recoverable from other co-obligors, reformation would plainly be permitted. Thus  
 13 the authors of New York Jurisprudence 2d write: "... the failure of a written  
 14 instrument to express the true intention of the parties because of a mutual mistake as  
 15 to the real meaning of the language used is a ground for reformation..." 16 New  
 16 York Jurisprudence 2d "Cancellation of Instruments" §72 at p.621. Insofar as it is  
 17 clear that FPIC was not intended to be a third party beneficiary of Endorsement  
 18 No. 3, it is doubtful whether FPIC even has standing to object to reformation.

#### 19 **IV. CONCLUSION**

20 This action must, as a matter of law, be stayed pending arbitration in  
 21 New York City. On the merits, the Commissioner has little or no chance of  
 22 avoiding liability for the Funds Withheld Balance. NICO is willing to be pragmatic  
 23 in negotiating a consensual resolution. Unfortunately, to date, the Commissioner

24 ///

25 ///

26 \_\_\_\_\_  
 27 <sup>2</sup> This was consistent with the understanding of the parties that the actual value of  
 28 consideration received by NICO was far less than the stated nominal value.



1 has expressed a disinclination to engage in serious bargaining. NICO welcomes the  
2 assistance of the Magistrate in seeking a just resolution.

3  
4 DATED: June 27 2008

MUSICK, PEELER & GARRETT llp

5  
6 By: s/Richard S. Conn  
7 Richard S. Conn  
8 Attorneys for NATIONAL INDEMNITY  
9 COMPANY  
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# **EXHIBIT A**

**EXHIBIT A**  
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Los Angeles, California 90017-3383  
TELEPHONE (213) 629-7612  
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Susan J. Field (State Bar No. 086200)  
s.field@mpglaw.com  
Richard S. Conn (State Bar No. 065513)  
r.conn@mpglaw.com  
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b.pulmanova@mpglaw.com

Attorneys for NATIONAL INDEMNITY COMPANY

**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA**

STEVE POIZNER, INSURANCE  
COMMISSIONER OF THE STATE  
OF CALIFORNIA, in his capacity as  
Liquidator of Frontier Pacific Insurance  
Company,

Plaintiff,

vs.

NATIONAL INDEMNITY  
COMPANY, a Nebraska corporation;  
and DOES 1 through 10,

Defendant.

Case No. 08 CV 772 L (POR)

Assigned to the Hon. M. James Lorenz  
Courtroom 14

Complaint Filed: March 17, 2008

**NOTICE OF MOTION AND  
MOTION OF DEFENDANT  
NATIONAL INDEMNITY  
COMPANY TO STAY  
PROSECUTION OF ACTION  
PENDING ARBITRATION OF  
CLAIMS**

**[SUPPORTING MEMORANDUM  
OF POINTS AND AUTHORITIES,  
DECLARATION OF RICHARD S.  
CONN; DECLARATION OF  
JOSEPH CASACCIO; AND  
[PROPOSED] ORDER FILED  
CONCURRENTLY HEREWITH]**

**DATE: August 18, 2008  
TIME: 10:30 a.m.  
COURTROOM: 14**

TO THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA  
AND TO ITS ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on August 18, 2008, at 10:30 a.m. or as

590064.1

**NOTICE OF MOTION AND MOTION OF DEFENDANT NATIONAL INDEMNITY COMPANY  
TO STAY PROSECUTION OF ACTION PENDING ARBITRATION OF CLAIMS**

1 soon thereafter as the matter may be heard, in Courtroom 14 of the above-entitled  
2 Court, located at 880 Front Street, San Diego, California 92101, Defendant National  
3 Insurance Company ("NICO"), will and hereby does move for an order staying the  
4 prosecution of this acting pending arbitration of claims. This motion is made  
5 pursuant to the Federal Arbitration Act, 9 U.S.C. §§ 1-9, on the ground that the  
6 reinsurance agreements at issue in this action provide for binding arbitration of any  
7 disputes thereunder.

8 This motion is based on the accompanying Memorandum of Points and  
9 Authorities, the Declaration of Richard S. Conn, the Declaration of Joseph Casaccio,  
10 and on the [Proposed] Order Staying Prosecution of Action Pending Arbitration of  
11 Claims lodged herewith, on the pleadings and papers on file herein, and on such  
12 further matters as may be presented in a reply memorandum at the hearing on this  
13 motion.

14  
15 DATED: June 27, 2008

MUSICK, PEELER & GARRETT LLP

16  
17 By: s/Richard S. Conn  
18 Richard S. Conn  
19 Attorneys for NATIONAL INDEMNITY  
20 COMPANY  
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**MUSICK, PEELER & GARRETT LLP**

ATTORNEYS AT LAW  
One Wilshire Boulevard, Suite 2000  
Los Angeles, California 90017-3383  
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FACSIMILE (213) 624-1376

Susan J. Field (State Bar No. 086200)  
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STEVE POIZNER, INSURANCE  
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Case No. 08 CV 772 L (POR)

Assigned to the Hon. M. James Lorenz  
Courtroom 14

Complaint Filed: March 17, 2008

**MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF  
DEFENDANT NATIONAL  
INDEMNITY COMPANY'S  
MOTION TO STAY  
PROSECUTION OF ACTION  
PENDING ARBITRATION OF  
CLAIMS**

**[NOTICE OF MOTION;  
DECLARATION OF RICHARD S.  
CONN; DECLARATION OF  
JOSEPH CASACCIO; AND  
[PROPOSED] ORDER FILED  
CONCURRENTLY HEREWITH]**

**DATE: August 18, 2008  
TIME: 10:30 a.m.  
COURTROOM: 14**

Defendant National Indemnity Company submits the following  
Memorandum of Points and Authorities in support of its Motion to Stay Proceedings  
Pending Arbitration:

589576.1

**MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANT  
NATIONAL INDEMNITY COMPANY'S MOTION TO STAY PROSECUTION OF ACTION  
PENDING ARBITRATION OF CLAIMS**

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**I. STATEMENT OF MATTERS IN CONTROVERSY**

This action has been brought by Steve Poizner, Insurance Commissioner of the State of California ("Plaintiff" or "Commissioner"), in his capacity as Liquidator of Frontier Pacific Insurance Company ("FPIC"). (Complaint, p. 1) Plaintiff seeks "a determination that [FPIC's] right to recover monies owed by National Indemnity Company ("NICO") pursuant to an indemnity contract is not subject to any claim of offset for monies that were presently owed to NICO from Frontier Insurance Company ("Frontier"), FPIC's parent company." (Complaint, p. 2, ¶ 1) Frontier and FPIC are subject to state court supervised insolvency proceedings in New York and California, respectively. (Complaint, p. 2, ¶¶ 4-5)

Plaintiff initially sued NICO in San Diego Superior Court. NICO caused the superior court action to be removed to this court on grounds of diversity - - Plaintiff being a citizen of California and NICO having its principal place of business and state of incorporation in Nebraska. (Complaint, pp. 2-3, ¶ 6)

The indebtedness of Frontier which NICO allegedly seeks to offset arose under a reinsurance agreement effective January 1, 1995, which is attached to the Complaint as Exhibit "A". (Complaint, p. 3, ¶ 9) The Complaint refers to this agreement as the Center Re Agreement, because Center Reinsurance Company of New York ("Center Re") was initially obligated as reinsurer thereunder. NICO became the ultimate Reinsurer under the Center Re Agreement by virtue of a Novation Agreement (Complaint, Ex. C) effective July 1, 2000. Both Frontier and FPIC were parties to the Novation Agreement. (Complaint, p. 4, ¶ 14) Under the Center Re Agreement, the Reinsured party was entitled to retain 92% of collected premium in order to defray losses (the "Center Re Funds Held"). Unexpended premium (the "Funds Withheld") was ultimately required to be remitted to the Reinsurer.

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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANT  
NATIONAL INDEMNITY COMPANY'S MOTION TO STAY PROSECUTION OF ACTION  
PENDING ARBITRATION OF CLAIMS

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2 Plaintiff alleges that as of October 15, 2001, when the Supreme Court  
3 of the State of New York issued an Order of Rehabilitation respecting Frontier,  
4 "Frontier owed approximately \$40 million in premiums to NICO under the  
5 Novation Agreement to fund the Center Re Funds Held deficiency due at December  
6 31, 2003." Review of the Center Re Agreement, Exhibit A, discloses that FPIC was  
7 jointly and severally liable for the same indebtedness: page one of Exhibit A  
8 defines Frontier and FPIC collectively as "the Company" and, pursuant to Article  
9 XIX, "[t]he Company promises to pay the Funds Withheld Balance" on the earlier  
10 of various stated contingencies. (Complaint, Ex. A, p. 7)

11 Notably, the Center Re Agreement contains the following provision for  
12 comprehensive, binding arbitration: "Any dispute arising out of the interpretation,  
13 performance or breach of this Agreement ... shall be submitted for decision to a  
14 panel of three arbitrators. \*\*\* The panel shall render its decision within sixty (60)  
15 days following the termination of hearings, which decision shall be in writing,  
16 stating the reasons thereof. Judgment upon the award may be entered in any court  
17 having jurisdiction thereof." (Complaint, Ex. A, pp. 17-18, Art. XXVII) The  
18 Center Re Agreement likewise provides for the arbitration to proceed in New York  
19 City, pursuant to the laws of the State of New York. (op. cit.)

20 NICO served as reinsurer for Frontier and FPIC under other agreements  
21 as well. (Complaint, ¶¶ 17) Among these was an agreement with Frontier effective  
22 July 1, 2000, (the "NICO Agreement") to which FPIC was added as a reinsured  
23 effective October 1, 2000. (Complaint, Exs. D and E)

24 Subsequent to initiation of Frontier's insolvency proceedings, NICO  
25 and Frontier entered into Endorsement No. 3 to the NICO Agreement. (FPIC was  
26 not a party to Endorsement No. 3.) Under Endorsement No. 3, NICO forgave and  
27 released Frontier of indebtedness in the amount of \$140,000,000. NICO agreed "not  
28 to collect [the Center Re Funds Held balance at December 31, 2003] from Frontier

1 (emph. supp.) as part of the \$140,000,000 NICO balance forgiveness ...”  
 2 (Complaint, Ex. H, p. 3, ¶¶ 8-9) While, pursuant to Endorsement No. 3, NICO  
 3 clearly thus foregoes recourse against Frontier for recovery of the Center Re Funds  
 4 Held balance, Endorsement No. 3 makes equally clear that NICO is not releasing  
 5 other obligors - - such as FPIC: “The Reinsurer agrees that it may only collect the  
 6 remaining funds held balance from the other participants to the Center Re  
 7 Reinsurance Agreements and Novation,” subject to a veto right by Frontier.<sup>1</sup>  
 8 (Complaint, Ex. H, p. 3, ¶ 9)

9 The Complaint alleges that “Endorsement No. 3 has been fully  
 10 performed by NICO and Frontier and Frontier and FPIC’s obligations under the  
 11 Reinsurance Agreements for payment of premium has been fully discharged and  
 12 satisfied.” (Complaint, p. 8, ¶ 37) Based on this contention, FPIC alleges NICO  
 13 currently holds no setoff rights (e.g. that NICO is owed no Withheld Funds) and that  
 14 NICO owes FPIC \$4,883,090 under the NICO Agreement. (Complaint, p. 9, ¶ 42;  
 15 Ex. M)

16 Notably the NICO Agreement, to which FPIC is a party, contains the  
 17 following provision for binding arbitration: “All matters in difference between the  
 18 Reinsured and the Reinsurer ... in relation to this reinsurance, including its  
 19 formation and validity, and whether arising during or after the period of this  
 20 reinsurance, shall be referred to an Arbitration Tribunal ... \*\*\* The award of the  
 21 Arbitration Tribunal shall be in writing and binding on the parties who covenant to  
 22 carry out the same.” (Complaint, Ex. D, p. 9, Art. 18) As with the Center Re  
 23 Agreement, the NICO Agreement provides that the Arbitration will proceed in New  
 24 York City, in accordance with the laws of the State of New York.

25  
 26 <sup>1</sup> Frontier had an interest in whether the Center Re Funds Held balance was  
 27 collected from other participants. To the extent the Center Re Funds Held balance  
 28 was applied against claims of FPIC, this would preserve limits available to Frontier  
 under the NICO Agreement.

1  
2 The Complaint alleges a right to declaratory relief as to three issues:  
3 that FPIC is not bound by Endorsement No. 3, as purportedly contended by NICO  
4 (Complaint, First Cause of Action, pp. 9-10); that Endorsement No. 3 constituted an  
5 accord and satisfaction as to the obligation of FPIC to pay the Center Re Funds Held  
6 balance (Complaint, Second Cause of Action, p. 10); and for a determination that  
7 NICO is barred by California Insurance Code section 1031 from setting off monies  
8 it owes FPIC against monies due NICO from Frontier and otherwise discharged by  
9 Endorsement No. 3. (Complaint, Third Cause of Action, pp. 10-11) The Complaint  
10 thus asks the Court to determine the legal effect of Endorsement No. 3 on the Center  
11 Re Agreement, as well as the validity of an affirmative defense raised by FPIC to  
12 claims of NICO under the Center Re Agreement: accord and satisfaction. *See Mass*  
13 *v. Melymont*, 1 Misc. 3d 906A, 2003 WL 23138786 (N.Y. Dist. Ct. 2003) ("In the  
14 case at bar, accord and satisfaction as an affirmative defense can be raised by  
15 defendant and employed successfully to preclude recovery providing that it is  
16 properly raised."). The Complaint in turn asks the Court to rule on an affirmative  
17 defense asserted by NICO to claims of FPIC under the NICO Agreement - - the  
18 affirmative defense of set off. *See Kivort Steel Inc. v. Liberty Leather Corp.*, 110  
19 A.D.2d 950, 952, 487 N.Y.S.2d 877 (1985).

20 The Complaint further implicitly asks the Court to indulge the  
21 assumption that FPIC is not now and never has been liable as a joint obligor with  
22 Frontier for payment of the Center Re Funds Held balance - a proposition belied by  
23 the very face of the Center Re Agreement.

24 NICO's Answer to Complaint discloses differences both over the  
25 nature of matters in controversy and the substantive rights of the parties. For  
26 example, NICO denies that Frontier has fully satisfied the Center Re Funds Held  
27 obligation by virtue of Endorsement No. 3. (Answer to Complaint, ¶ 37) NICO  
28 denies that its claim of set off arises under Endorsement No. 3 (Answer, p. 10, ¶ 46),



1 or by virtue of the indebtedness of Frontier, maintaining that it is entitled to assert  
 2 setoff by virtue of the joint and several liability of FPIC as part of the collective  
 3 "Company" under the Center Re Agreement. Similarly, NICO denies that  
 4 Endorsement No. 3 has the legal effect of an accord and satisfaction as to FPIC.  
 5 (Answer to Complaint p. 11, ¶ 50) To the extent that Endorsement No. 3 is  
 6 susceptible to such a construction, NICO maintains that it is subject to reformation.  
 7 (Answer to Complaint p. 12, ¶ 56) NICO further maintains that Frontier is an  
 8 indispensable party to any dispute resolution process addressing rights under the  
 9 Center Re Agreement and NICO Agreement. (Answer to Complaint p. 12, ¶ 55)

10 Remarkably, although both of the agreements which give rise to the  
 11 current controversy provide for binding arbitration, the Plaintiff has refused NICO's  
 12 demand to submit the instant controversy to binding arbitration. (Declaration of  
 13 Richard S. Conn) It is this refusal which necessitates the instant motion to stay this  
 14 litigation pending arbitration proceedings mandated by the Federal Arbitration Act.

## 15 **II. GROUNDS FOR RELIEF SOUGHT**

16 By means of this motion NICO seeks an order staying prosecution of  
 17 this action pending a resolution of all claims by binding arbitration. Issuance of a  
 18 stay order is authorized by Section 3 of the Federal Arbitration Act, 9 U.S.C. § 3,  
 19 which provides:

20 "If any suit or proceeding be brought in any of the courts  
 21 of the United States upon any issue referable to arbitration  
 22 under an agreement in writing for such arbitration, the  
 23 court in which such suit is pending, upon being satisfied  
 24 that the issue involved in such suit or proceeding is subject  
 25 to arbitration under such agreement, shall on application of  
 26 one of the parties stay the trial of the action until  
 27 arbitration has been had in accordance with the terms of  
 28 the agreement, providing the applicant for the stay is not in



1 default in proceeding with such arbitration.”

2 If the conditions of Section 3 are satisfied (e.g. the dispute is referable  
3 to arbitration) issuance of a stay is mandatory. See *Complaint of Hornbeck*  
4 *Offshore*, 981 F.2d 752, 754 (5th Cir. 1993); *Gutierrez v. Academy Corp.*, 967  
5 F. Supp. 945, 947 (S.D. Tex. 1997); *Campeau Corp. v. May Dept. Stores Co.*, 723  
6 F. Supp. 224, 226 (S.D.N.Y.1989).

7 Notably, a stay order may be issued independently of an order  
8 compelling arbitration. Indeed, this may be necessitated where, as here, the action  
9 to be stayed has been filed in a jurisdiction other than that where the arbitration is to  
10 occur. (The instant arbitration provisions specify New York, New York as the locus  
11 of the arbitration.) This follows from the proviso of 9 U.S.C. § 4 that the compelled  
12 arbitration hearing “shall be within the district in which the petition directing such  
13 arbitration is filed.” Since this court arguably cannot issue an order compelling  
14 arbitration in New York, it is entirely proper that the relief sought by the aggrieved  
15 party be limited to a stay order. See *Merrill Lynch, Pierce, Fenner & South Inc. v.*  
16 *Lauer*, 49 F.3d 323, 327-328 (7th Cir. 1995); *Petition of Home Ins. Co.*, 908  
17 F. Supp. 180, 182 (S.D.N.Y. 1995).

18 **III. ARGUMENT: THE COURT SHOULD STAY THIS ACTION**  
19 **PENDING ARBITRATION OF CLAIMS**

20 **A. The Parties’ Arbitration Agreements Unambiguously Require**  
21 **Arbitration Of This Dispute.**

22 In entering into the Center Re Agreement and Novation Agreement  
23 described above, NICO and FPIC agreed to arbitrate “any dispute arising out of the  
24 interpretation, performance or breach of this Agreement.” (Complaint, Ex. B, p. 17)  
25 The arbitration provision under the NICO Agreement is no less broad: “All matters  
26 in difference between the Reinsured and Reinsurer ... in relation to this reinsurance  
27 ... shall be referred to an Arbitration Tribunal ...” (Complaint, Ex. D, p. 9) These  
28 provisions unambiguously require arbitration of all disputes, including NICO’s

obligations to the FPIC and NICO's right to set off sums due NICO from FPIC.

1. **Both Federal And California Law Strongly Favor  
Arbitration And Require That Arbitration Agreements  
Be Broadly Construed.**

In its decision in *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852 (1984), the United States Supreme Court ruled that the Federal Arbitration Act ("FAA") governs the issue of arbitrability of disputes under any agreement to arbitrate that affects interstate commerce.<sup>2</sup> Thus, the Supreme Court in *Southland* held that "the underlying issue of arbitrability" in such a case is "a question of substantive federal law." *Southland Corp.*, 465 U.S. at 12, 104 S.Ct. at 859. See also *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626, 105 S.Ct. 3346, 3353 (1985) (in determining whether a dispute is subject to arbitration, the Court is to apply "'federal substantive law of arbitrability, applicable to any arbitration agreement within coverage of the [Federal Arbitration] Act'" (quoting *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 941 (1983))). Accordingly, federal law controls the issue of whether NICO's claims to a setoff are subject to arbitration. As demonstrated below, however, the issue of which law controls here is essentially moot as both federal and California law require arbitration.

The courts have consistently held that the strong policy favoring arbitration requires that agreements to arbitrate be broadly construed. The FAA,

<sup>2</sup> The reinsurance agreements at issue here are contracts "evidencing a transaction involving commerce" within the meaning of section 2 of the FAA, 9 U.S.C. § 2. See, e.g., *Ainsworth v. Allstate Insurance Co.*, 634 F. Supp. 52, 55-56 (W.D. Mo. 1985) (reinsurance agreements were contracts "evidencing a transaction involving commerce" within the FAA). Indeed, as the *Ainsworth* court noted, "that the agreements involve insurance may be enough to establish the interstate commerce connection." *Id.* at 55. Accord *Bernstein v. Centaur Insurance Co.*, 606 F. Supp. 98, 101 (S.D.N.Y. 1984) ("insurance is business in interstate commerce" under FAA); see also *United States v. South Eastern Ass'n*, 322 U.S. 533, 539-53, 64 S.Ct. 1162, 1166-73 (1944) (fire insurance business is interstate commerce under Commerce Clause and Sherman Act).

1 “both through its plain meaning and the strong federal policy it reflects, requires  
2 courts to enforce the bargain of the parties to arbitrate, and ‘not substitute [its] own  
3 views of economy and efficiency’ for those of Congress.” *Dean Witter Reynolds,*  
4 *Inc. v. Byrd*, 470 U.S. 213, 105 S.Ct. 1238, 1241 (1985). In light of this policy:

5 An order to arbitrate the particular grievance should not be  
6 denied unless it may be said with positive assurance that  
7 the arbitration clause is not susceptible of an interpretation  
8 that covers the asserted dispute. Doubts should be  
9 resolved in favor of coverage.

10 *United Steelworkers of America v. Warrior Gulf Navigation Co.*, 363 U.S. 574,  
11 582-83, 80 S.Ct. 1347, 1353 (1960). As the Supreme Court observed in a  
12 subsequent decision:

13 ‘questions of arbitrability must be addressed with a  
14 healthy regard for the federal policy favoring arbitration  
15 ... The Arbitration Act establishes that, as a matter of  
16 federal law, any doubts concerning the scope of arbitrable  
17 issues should be resolved in favor of arbitration, whether  
18 the problem at hand is the construction of the contract  
19 language itself or an allegation of waiver, delay, or a like  
20 defense to arbitrability.’

21 *Mitsubishi Motors*, 473 U.S. at 626, 105 S.Ct. at 3353-54 (quoting *Moses H. Cone*  
22 *Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. at 24-25, 103 S.Ct. at  
23 941-42).

24 California decisions are fully in accord with the foregoing rules. *E.g.*,  
25 *Bos Material Handling, Inc. v. Crown Controls Corp.*, 137 Cal. App. 3d 99, 105,  
26 186 Cal.Reptr. 740 (1982) (“In California, the general rule is that arbitration should  
27 be upheld unless it can be said with assurance that an arbitration clause is not  
28 susceptible to an interpretation covering the asserted dispute”).

1  
2 Under the above standard, not only claims, but also affirmative  
3 defenses to claims, must be arbitrated. Thus, the Court in *Republic of Nicaragua v.*  
4 *Standard Fruit Co.*, 937 F.2d 469, 478 (9th Cir. 1991) *cert. den.* 503 U.S. 919 states  
5 that, when “enforcing agreements to arbitrate,” a court must “leav[e] the merits of  
6 the claims and any defense to the arbitrator.” (emph. supp.) When a dispute is  
7 subject to arbitration, the entire dispute - - including both claims and defenses  
8 - - must be arbitrated. *See e.g. Prima Paint Corp. v. Flood & Conklin Mfg.*, 388  
9 U.S. 395, 404 (1967) (defense of fraudulent inducement to be decided by arbitrators  
10 hearing breach of contract claim); *National Union Fire Ins. Co. v. Belco Petroleum*  
11 *Corp.*, 88 F.3d 129 (2d Cir. 1996) (preclusion defense to be decided by arbitrators);  
12 *O’Neel v. NASD*, 667 F.2d 804, 807 (9th Cir. 1982) (statute of limitations defense  
13 to be decided by arbitrators).

14 The mandate for arbitration applies equally where, as here, a later  
15 executed settlement with a third party is the basis of the claimed defense. *Local*  
16 *Union No. 370, Int’l Union of Operating Eng’rs v. Morrison-Knudson Co.*, 786 F.2d  
17 1356, 1357-1358 (9th Cir. 1986). Nor have courts treated the defense of setoff as  
18 exempt from arbitration. *Quackenbush v. Allstate Insurance Co.*, 121 F.3d 1372,  
19 1380 (9th Cir. 1997).

20 Likewise, statutory claims, such as claims under the Racketeer  
21 Influenced and Corrupt Organizations Act (RICO) and the federal securities laws,  
22 must be submitted to arbitration when they fall within the scope of a contractual  
23 agreement to arbitrate, unless Congress has expressly created an exception to the  
24 Federal Arbitration Act. *Rodriguez de Quijas v. Shearson/ American Express, Inc.*,  
25 109, S.Ct. 1917, 104 L.Ed.2d 526 (1989) (ordering arbitration of claims under  
26 Securities Act of 1933); *Shearson/American Express, Inc. v. McMahon*, 482 U.S.  
27 220, 107 S.Ct. 2332 (1987) (compelling arbitration of RICO claims and claims  
28 under Securities Exchange Act of 1934).

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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANT  
NATIONAL INDEMNITY COMPANY’S MOTION TO STAY PROSECUTION OF ACTION  
PENDING ARBITRATION OF CLAIMS

2. **Under The Foregoing Standard, The Dispute Presented Here Is Within The Scope Of The Parties' Agreements To Arbitrate And Must Be Arbitrated By The Commissioner.**

There can be no dispute whether the claims asserted in this case fall within the scope of the parties' arbitration agreements. The Commissioner effectively seeks to recover reinsurance balances that have accrued under a reinsurance agreement pursuant to which NICO reinsured FPIC. This agreement has an arbitration provision. NICO seeks to set off balances that are due it under another reinsurance agreement pursuant to which NICO acted as FPIC's reinsurer. This reinsurance agreement also has an arbitration provision. These claims lie at the very heart of the contracts of reinsurance at issue in this case. It is difficult to imagine a clearer instance of a dispute concerning rights under the reinsurance agreements. Although citation of authority is hardly necessary, the cases have found that such disputes fall within the scope of arbitration agreements akin to those here, and are fully enforceable against liquidators of insurance companies. *E.g.* *Quackenbush v. Allstate Insurance Co.*, 121 F.3d 1372, 1380 (9th Cir. 1997) (compelling arbitration of dispute between Insurance Commissioner as Liquidator and reinsurer over rights of setoff); *Bennett v. Liberty National Fire Ins. Co.*, 968 F.2d 969, 971, 972 (9th Cir. 1992) (insurer's liquidator bound by insurer's pre-insolvency agreement to arbitrate all disputes arising out of its contractual relationship); *Ainsworth v. Allstate Insurance Co.*, 634 F. Supp. 52, 53-56 (W.D. Mo. 1985) (receiver of insolvent insurers must arbitrate claim against reinsurer in view of arbitration agreements contained in reinsurance treaties).

For the foregoing reasons, the Court should stay prosecution of this action pending a resolution of all claims through arbitration.

The foregoing decisions are consistent with the status of the Insurance Commissioner under the California Insurance Code. As several California decisions have recognized, the Insurance Commissioner, when acting as a conservator or



1 liquidator of an insolvent insurance company, has duties in the nature of a receiver.  
 2 *E.g., Anderson v. Great Republic Life Insurance Co.*, 41 Cal. App. 2d 181, 106 P.2d  
 3 75 (1940). It has long been the law that “[a] receiver sues only on a cause of action  
 4 of the parties or estate represented, and is subject to the same defenses which would  
 5 have been available against them.” 4 B. Witkin, *California Procedure, Pleading*  
 6 § 127 at 160 (1985); *see also, Allen v. Ramsay*, 179 Cal. App. 2d 843, 854, 4 Cal.  
 7 Rptr. 575 (1960) (“A receiver occupies no better position than that which was  
 8 occupied by the person or party for whom he acts and the receiver takes the property  
 9 and the rights of one for whom he was appointed in the same condition and subject  
 10 to the same equities as existed before his appointment and any defense good against  
 11 the original party is good against the receiver”). Thus, the Commissioner’s power to  
 12 avoid enforcement of an arbitration agreement can be no greater than that of FPIC,  
 13 in whose shoes he must stand.

14           The McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15, does not lead to a  
 15 contrary result. The McCarran-Ferguson Act provides in relevant part that “[n]o  
 16 Act of Congress shall be construed to invalidate, impair or supersede any law  
 17 enacted by any State for the purpose of regulating the business of insurance . . .  
 18 unless such Act specifically relates to the business of insurance.” 15 U.S.C.  
 19 § 1012(b). The Ninth Circuit, however, has expressly held that state insurance law  
 20 does not preempt the Federal Arbitration Act except in the event of an express  
 21 conflict (*e.g.* a statute prohibiting arbitration of disputes with a liquidator).  
 22 *Quackenbush v. Allstate Ins. Co.*, 121 F.3d at 1380-1381, citing *U.S. Dept. of*  
 23 *Treasure v. Fabe*, 508 U.S. 491, 113 S.Ct. 2202 (1993); and *Bennett v. Liberty*  
 24 *National Fire Ins. Co.*, 968 F.2d 969, 971-972. As acknowledged in *Quackenbush*,  
 25 *supra*, no such conflict exists under California law.

26           **B. Arbitration Of Reinsurance Disputes Is Particularly Appropriate.**

27           That the present dispute concerns rights and obligations under  
 28 reinsurance agreements makes arbitration particularly suitable. More than forty

1 years ago it was observed that “[i]t is the general practice and practically the  
 2 uniform custom to provide in a [reinsurance] treaty for the arbitration of disputes  
 3 arising out of the terms of the treaty.” K. Thompson, Reinsurance (4th Ed. 1966) at  
 4 140. The federal courts, moreover, have routinely and repeatedly compelled  
 5 arbitration of reinsurance disputes arising under such arbitration agreements. For  
 6 instance, in *Houston General Insurance Co. v. Reallex Group, N.V.*, 776 F.2d 514  
 7 (5th Cir. 1985), the Court of Appeal reversed a District Court order which had  
 8 refused to compel arbitration under the FAA of a suit substantially like that here:  
 9 one brought by an insurer against its reinsurer seeking to recover balances due on a  
 10 policy of reinsurance. *Houston General*, 776 F.2d at 516-17. Indeed, the Ninth  
 11 Circuit ordered arbitration of a reinsurance dispute as early as 1928. *Pacific*  
 12 *Indemnity Co. v. Insurance Co. of North America*, 25 F.2d 930 (9th Cir. 1928).

13           The near universality of arbitration agreements in the reinsurance  
 14 industry has resulted from a number of factors. Among other things, arbitration  
 15 offers a relatively prompt, expeditious method for determining the reinsurer’s  
 16 obligation, if any, to pay reinsurance balances in dispute. Also, a resolution of  
 17 reinsurance disputes involves both specialized terminology and a system of  
 18 accounting that is unique to the insurance industry. Indeed, reinsurance disputes are  
 19 so idiosyncratic that reinsurance arbitration agreements typically “require the  
 20 arbitrators to be recognized authority in the field of which the case arises.”

21 K. Thompson, Reinsurance, at 140. The arbitration agreements at issue here contain  
 22 just such provisions, requiring that the “arbitrators shall be disinterested active or  
 23 former executive officers of insurance or reinsurance companies” (Complaint,  
 24 Ex. A, p. 17, Art. XXVII D) or “persons employed or engaged in a senior position in  
 25 Insurance or Reinsurance underwriting or claims.” (Complaint, Ex. D, p. 9, Art. 18)

26           The determination of the conflicting claims of NICO and FPIC would  
 27 involve terminology and an accounting system that are unique to the reinsurance  
 28 context. Judicial resolution of this dispute would put the parties to extraordinary

burden and expense, not to mention the expenditure of this Court's resources.

For the foregoing reasons, the Court should issue an order staying prosecution of this action as against NICO. Such an order is mandated by section 3 of the Federal Arbitration Act, 9 U.S.C. § 3, which provides that a court "shall" stay a civil action when it is subject to arbitration.

**C. The Order Of The Liquidation Of FPIC Is No Bar To The Relief Sought.**

The Commissioner may argue that the Order Appointing Commissioner As Liquidator And Restraining Order (the "Order") issued by the Superior Court supervising FPIC's liquidation impedes the right of NICO to compel arbitration. A careful reading of the Order discloses that the Order merely has the effect of preserving assets over which the court exercises in rem jurisdiction from impairment by imposition of liens, execution, levy, and the like.<sup>3</sup> Nothing in the Order prohibits

<sup>3</sup> The specific provisions on which the Commissioner has placed reliance are Paragraphs 24 through 29, which provide:

24. All persons are enjoined, except with leave of this Court issued after a hearing in which the Commissioner as Liquidator has received reasonable notice, from obtaining preferences, judgments, attachments or other liens, or making any levy against Respondent or its assets or property, and from executing or issuing or causing the execution or issuance of any court attachment, subpoena, replevin, levy, execution or other process for the purpose of impounding or taking possession of Respondent or its affiliates, or the Liquidator appointed herein, wheresoever situated and from doing any interfering with the conduct of said business by the Commissioner as Liquidator.

25. All persons are enjoined, except by leave of this Court obtained after reasonable notice to the Commissioner as Liquidator, from accelerating the due date of any obligation or claimed obligation; exercising any right of set-off; taking, retaining, retaking or attempting to retake possession of any real or personal property; withholding or diverting any rent or other obligation; doing any act or other thing whatsoever to interfere with the possession of or management by the Commissioner as Liquidator and of the property and assets, owned or controlled by Respondent or in the possession of Respondent or to in any way interfere with said Commissioner as Liquidator or to interfere in any manner during the pendency of this proceeding with the exclusive jurisdiction of this Court over Respondent.

1 award of declaratory relief by arbitration. Indeed, in the absence of a California  
 2 statute prohibiting arbitration of disputes by a liquidator, such an order would

3  
 4 26. Respondent, its officers, directors, governors, agents, and  
 5 employees are enjoined from transacting any of the business of  
 6 Respondent, whether in the State of California or elsewhere, or from  
 disposing of, or assisting any person in the transfer or alienation of, the  
 property or assets of Respondent, until further order of this Court.

7 27. All persons are enjoined from instituting, prosecuting or  
 8 maintaining any action at law or suit in equity, including but not  
 9 limited to actions or proceedings to compel discovery or production of  
 10 documents or testimony and matters in arbitration, against Respondent  
 11 or against the Commissioner as Liquidator of Respondent, and from  
 attaching, executing foreclosure upon, redeeming of or taking any other  
 legal proceedings against, any of the property or assets of Respondent,  
 and from doing any act interfering with the conduct of said business by  
 the Commissioner as Liquidator, except upon order from this Court  
 obtained after reasonable notice to the Commissioner as Liquidator.

12 28. Any and all provisions of any agreement entered into by and  
 13 between any third party and Respondent including, by way of  
 14 illustration, but not limited to, the following types of agreements (as  
 15 well as any amendments, assignments, or modifications thereto);  
 16 financial guarantee bonds, promissory notes, loan agreements, security  
 17 agreements, deeds of trust, mortgages, indemnification agreements,  
 18 subrogation agreements, subordination agreements, pledge agreements,  
 19 assignments of rents or other collateral, financial statements, letters of  
 20 credit, leases, insurance policies, guaranties, escrow agreements,  
 21 management agreements, real estate brokerage and rental agreements,  
 22 servicing agreements, attorney agreements, consulting agreements,  
 23 easement agreements, license agreements, franchise agreements, or  
 employment contracts that provide in any manner that selection,  
 appointment or retention of a conservator, or liquidator or trustee by  
 any court, or entry of an order such as hereby made, shall be deemed to  
 be or otherwise operate as a breach, violation, event of default,  
 termination, event of dissolution, event of acceleration, insolvency,  
 bankruptcy, or liquidation, shall be stayed, and the assertion of any and  
 all rights, remedies relating thereto shall also be stayed and barred,  
 except as otherwise ordered by this Court, and this Court shall retain  
 jurisdiction over any cause of action that has arisen or may otherwise  
 arise under any such provision.

24 29. All persons are enjoined from interfering with the possession,  
 25 title and rights of the Commissioner as Liquidator, in and to the assets  
 26 of Respondent, and from interfering with the conduct of the  
 27 Commissioner as Liquidator in the handling and disposition of assets of  
 Respondent, and from interfering with the conduct of the liquidation  
 and the winding up of the business of Respondent, except upon order of  
 this Court obtained after reasonable notice to the Commissioner as  
 Liquidator.



1 contravene the Federal Arbitration Act and would, as such, be void. As the Court  
 2 held in *Quackenbush*, 121 F.3d at 1381, arbitration of claims pursued by a California  
 3 liquidator outside of the statutory insolvency proceedings "will not interfere with  
 4 California's insolvency scheme" and is therefore controlled by the Federal  
 5 Arbitration Act.

6 Furthermore, to the extent the Order might be deemed to contravene the  
 7 Federal Arbitration Act, it is properly challenged by disregard. *People v. Gonzalez*,  
 8 12 Cal.4th 804, 818-819, 50 Cal. Rptr. 2d 74 (1996).

9 **IV. CONCLUSION**

10 As demonstrated above, both federal and California law guarantee  
 11 NICO's right to arbitrate its dispute with the FPIC and the Commissioner. This  
 12 Court should therefore stay prosecution of this action by the Commissioner pending  
 13 resolution of all claims by arbitration, as the parties expressly agreed in the  
 14 reinsurance agreements that are the subject of this action.

15  
 16 DATED: June 27, 2008

MUSICK, PEELER & GARRETT LLP

17  
 18 By: s/Richard S. Conn  
 19 Richard S. Conn  
 20 Attorneys for NATIONAL INDEMNITY  
 21 COMPANY  
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**MUSICK, PEELER & GARRETT LLP**

ATTORNEYS AT LAW

One Wilshire Boulevard, Suite 2000  
Los Angeles, California 90017-3383  
TELEPHONE 213-629-7612  
FACSIMILE (213) 624-1376

Susan J. Field (State Bar No. 086200)  
s.field@mpglaw.com  
Richard S. Conn (State Bar No. 065513)  
r.conn@mpglaw.com  
Barbora Pulmanova (State Bar No. 234028)  
b.pulmanova@mpglaw.com

Attorneys for NATIONAL INDEMNITY COMPANY

**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA**

STEVE POIZNER, INSURANCE  
COMMISSIONER OF THE STATE  
OF CALIFORNIA, in his capacity as  
Liquidator of Frontier Pacific Insurance  
Company,

Plaintiff,

vs.

NATIONAL INDEMNITY  
COMPANY, a Nebraska corporation;  
and DOES 1 through 10,

Defendant.

Case No. 08 CV 772 L (POR)

Assigned to the Hon. M. James Lorenz  
Courtroom 14

Complaint Filed: March 17, 2008

**DECLARATION OF RICHARD S.  
CONN IN SUPPORT OF  
DEFENDANT NATIONAL  
INDEMNITY COMPANY'S  
MOTION TO STAY  
PROSECUTION OF ACTION  
PENDING ARBITRATION OF  
CLAIMS**

**[NOTICE OF MOTION;  
MEMORANDUM OF POINTS AND  
AUTHORITIES; DECLARATION  
OF JOSEPH CASACCIO; AND  
[PROPOSED] ORDER FILED  
CONCURRENTLY HERewith]**

**DATE: August 18, 2008  
TIME: 10:30 a.m.  
COURTROOM: 14**

593915.1

**DECLARATION OF RICHARD S. CONN IN SUPPORT OF DEFENDANT NATIONAL INDEMNITY  
COMPANY'S MOTION TO STAY PROSECUTION OF ACTION PENDING ARBITRATION OF CLAIMS**



**DECLARATION OF RICHARD S. CONN**

I, Richard S. Conn, declare:

1. At all times herein pertinent I have been a partner with the firm of Musick, Peeler & Garrett LLP, counsel for defendant National Indemnity Company ("NICO"). As such, the facts set forth herein are known to me personally and if called as a witness I could and would competently testify thereto.

2. On April 29, 2008, I caused the state court action filed by Steve Poizner, Insurance Commissioner of the State of California (the "Commissioner"), as Liquidator for Frontier Pacific Insurance Company ("FPIC") against NICO to be removed to this court, on grounds of diversity. Following the removal, and filing of the Answer to Complaint by NICO, my review of the pleadings convinced me that the controversies reflected by the Complaint and Answer to Complaint were subject to binding arbitration pursuant to the following provisions of the Center Re Agreement and the NICO Agreement:

"Any dispute arising out of the interpretation, performance or breach of [the NICO] Agreement ... shall be submitted for decision to a panel of three arbitrators. \*\*\* The panel shall render its decision within sixty (60) days following the termination of hearings, which decision shall be in writing, stating the reasons thereof. Judgment upon the award may be entered in any court having jurisdiction thereof."

\* \* \*

"All matters in difference between the Reinsured and the Reinsurer ... in relation to [the NICO Policy], including its formation and validity, and whether arising during or after the period of this reinsurance, shall be referred to an Arbitration Tribunal ... \*\*\* The award of the Arbitration

593915.1

2

DECLARATION OF RICHARD S. CONN IN SUPPORT OF DEFENDANT NATIONAL INDEMNITY COMPANY'S MOTION TO STAY PROSECUTION OF ACTION PENDING ARBITRATION OF CLAIMS

Tribunal shall be in writing and binding on the parties who  
covenant to carry out the same.”

3. In order to determine whether a controversy existed concerning the duty of the parties to submit their dispute to arbitration (and to avoid unnecessary imposition on the court), on May 8, 2008, on behalf of NICO, I sent Lazlo Komjathy Jr., legal counsel for the Commissioner, the letter demanding arbitration, a true and correct copy of which is attached hereto as Exhibit 1.

4. On May 23, 2008, I received the response to my demand, a true and correct copy of which is attached hereto as Exhibit 2. While in his response, Mr. Komjathy does not contest that disputes under the Center Re Agreement and NICO Agreement must be submitted to arbitration, the response rejects any duty on the part of Commissioner to arbitrate the pending controversy, arguing that the Commissioner seeks only to construe Endorsement No. 3. Mr. Komjathy further contends that NICO must seek relief from the liquidation court prior to moving to compel arbitration.

5. In his response, Mr. Komjathy refers to a Liquidation Order previously provided to me as the basis for the alleged exclusive jurisdiction of the liquidation court. A true and correct copy of this order is attached hereto as Exhibit 3.

6. In prior email correspondence, I had directed Mr. Komjathy's attention to the holding in *Quackenbush v. Allstate Ins. Co.*, (9th Cir. 1997) 121 F.3d 1372, 1380-81, stating that California insurance law does not preempt the Federal Arbitration Act or eliminate the duty of a liquidator to submit claims like those presented here to arbitration. Mr. Komjathy's letter does not respond to this citation of controlling authority.

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1 I declare under penalty of perjury under the laws of the United States of  
2 America that the foregoing is true and correct.

3 Executed this 27<sup>th</sup> day of June, 2008, at Los Angeles, California.  
4

5 s/Richard S. Conn

6 Richard S. Conn  
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**MUSICK, PEELER & GARRETT LLP**

ATTORNEYS AT LAW  
One Wilshire Boulevard, Suite 2000  
Los Angeles, California 90017-3383  
TELEPHONE (213) 629-7612  
FACSIMILE (213) 624-1376

Susan J. Field (State Bar No. 086200)  
s.field@mpglaw.com  
Richard S. Conn (State Bar No. 065513)  
r.conn@mpglaw.com  
Barbora Pulmanova (State Bar No. 234028)  
b.pulmanova@mpglaw.com

Attorneys for NATIONAL INDEMNITY COMPANY

**UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF CALIFORNIA**

STEVE POIZNER, INSURANCE  
COMMISSIONER OF THE STATE  
OF CALIFORNIA, in his capacity as  
Liquidator of Frontier Pacific Insurance  
Company,

Plaintiff,

vs.

NATIONAL INDEMNITY  
COMPANY, a Nebraska corporation;  
and DOES 1 through 10,

Defendant.

Case No. 08 CV 772 L (POR)

Assigned to the Hon. M. James Lorenz  
Courtroom 14

Complaint Filed: March 17, 2008

**DECLARATION OF JOSEPH  
CASACCIO IN SUPPORT OF  
DEFENDANT NATIONAL  
INDEMNITY COMPANY'S  
MOTION TO STAY  
PROSECUTION OF ACTION  
PENDING ARBITRATION OF  
CLAIMS**

**[NOTICE OF MOTION;  
MEMORANDUM OF POINTS AND  
AUTHORITIES; DECLARATION  
OF RICHARD S. CONN; AND  
[PROPOSED] ORDER FILED  
CONCURRENTLY HEREWITH]**

**DATE: August 18, 2008  
TIME: 10:30 a.m.  
COURTROOM: 14**

593916.1

**DECLARATION OF JOSEPH CASACCIO IN SUPPORT OF DEFENDANT NATIONAL INDEMNITY  
COMPANY'S MOTION TO STAY PROSECUTION OF ACTION PENDING ARBITRATION OF CLAIMS**

**DECLARATION OF JOSEPH CASACCIO**

I, Joseph Casaccio, declare:

1. At all times herein pertinent I was, and now am, Vice President of National Insurance Company ("NICO") defendant herein. As such, the facts set forth herein are known to me personally and if called as a witness I could competently testify thereto.

2. By means of the instant motion, NICO seeks an order staying these proceedings pending arbitration of the controversies framed by the pleadings. The agreements providing for binding arbitration of disputes with Frontier Pacific Insurance Company ("FPIC") are attached to the Complaint of Plaintiff Insurance Commissioner (the "Commissioner") as Exhibits A (the "Center Re Agreement"), C (the "Novation Agreement"), D (the "NICO Agreement"), E (Endorsement 1 to the NICO Agreement) and G ("Endorsement 2 to the NICO Agreement"). True and correct copies of such exhibits are attached hereto for the convenience of the Court as Exhibits 4A, 4C, 4D, 4E and 4G. A true and correct copy of Endorsement No. 3 to the NICO Agreement, Exhibit H to the Commissioner's Complaint, is attached hereto as Exhibit 4H.

3. The Center Re Agreement and the NICO Agreement each provide for reinsurance of risks in multiple states. These contracts thus affect interstate commerce.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed this 13<sup>th</sup> of June, 2008 at Stamford, Connecticut.

  
\_\_\_\_\_  
Joseph Casaccio

**PROOF OF SERVICE**

STATE OF CALIFORNIA  
COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within entitled action; my business address is One Wilshire Boulevard, Suite 2000, Los Angeles, California 90017-3383.

On June 27, 2008, I served the foregoing document(s) described as **MEMORANDUM OF DEFENDANT NATIONAL INDEMNITY CO. IN AID OF EARLY NEUTRAL EVALUATION CONFERENCE** on the interested parties in this action by placing a copy thereof enclosed in a sealed envelope addressed as follows:

**See Attached List**

☒ **BY MAIL.** I caused such envelope with postage thereon fully prepaid to be placed in the U.S. Mail at Los Angeles, California. I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice, it would be deposited with the U.S. postal service on that same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

☒ **BY ELECTRONIC MAIL OR ELECTRONIC TRANSMISSION.** Based upon the Court's order for mandatory e-filing, I provided the documents listed above electronically to the Court's website and thereon to those parties on the Service List maintained by that website by submitting an electronic version of the documents to the Court's website. The documents are deemed filed and served on the date that they were uploaded to the Court's website.

☐ **BY FACSIMILE TRANSMISSION.** I caused such document to be transmitted to the addressee(s) facsimile number(s) noted herein. The facsimile machine used complies with Rule 2003 and no error was reported by the machine. Pursuant to Rule 2008(e), I caused the machine to print a transmission record of the transmission, a copy of which is attached to this declaration.

Executed on June 27, 2008, at Los Angeles, California.

☐ **(State)** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

☒ **(Federal)** I declare that I am employed in the office of a member of the bar of this Court at whose direction the service was made. I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

s/Kathleen Slevcove  
Kathleen Slevcove



**SERVICE LIST**

EDMUND G. BROWN, JR.  
Attorney General of the State of  
California

W. DEAN FREEMAN  
Supervising Deputy Attorney General  
DIANE SPENCER SHAW

LISA W. CHAO  
Deputy Attorneys General  
300 South Spring Street, Suite 1702  
Los Angeles, California 90013

Telephone: (213) 897-2486  
Fax: (213) 897-5775

LAZLO KOMJATHY, JR.  
Department of Insurance  
45 Fremont Street, 24<sup>th</sup> Floor  
San Francisco, California 94105

Telephone: (415) 538-4413

Attorneys for Plaintiff Steve Poizner,  
Insurance Commissioner of the State of  
California in his capacity as Liquidator  
of Frontier Pacific Insurance Company

Attorneys for Plaintiff Steve Poizner,  
Insurance Commissioner of the State of  
California in his capacity as Liquidator  
of Frontier Pacific Insurance Company